

Message Text

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INFO OCT-01 ISO-00 AID-20 CEA-02 CIAE-00 COME-00 EB-11

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TO SECSTATE WASH DC 3242

INFO AMEMBASSY COPENHAGEN

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TAGS: ECON, OECD

SUBJECT: EDRC ANNUAL REVIEW OF DENMARK

REF: (A) USOECD 1484L, (B) COPENHAGEN 1704, (C)
OECD DOC EDR (74)17

1. SUMMARY: AT JUNE 21 ANNUAL REVIEW OF DENMARK, EDRC CONCLUDED THAT 1973 PERFORMANCE WAS INDEED YEAR OF LOST OPPORTUNITIES ON EXPORT SIDE, AND THAT MANY 1974 PROBLEMS WERE DUE TO INSUFFICIENT DEMAND RESTRAINT IN 1973. DANES DEFENDED MAY 1974 TAX MEASURES AND WERE CONFIDENT THAT PROPOSED 1975 TAX CHANGES WILL NOT UNDERMINE DEMAND RESTRAINT POLICIES. THEY ADMITTED DISSATISFACTION WITH SYSTEM OF WAGE INDEXATION AND HOPED TO ESTABLISH TRADE OFF IN FUTURE WAGE NEGOTIATIONS BETWEEN WAGE INCREASES AND TAX REDUCTIONS. EXTERNAL BALANCE EXPECTED TO IMPROVE WITH NON-OIL CURRENT BALANCE REACHING EQUILIBRIUM BY END OF 1974. END SUMMARY.

2. PERFORMANCE IN 1973: DANES CLAIMED THAT INFLATION

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IN 1973 WAS PRIMARILY DUE TO RISING IMPORT PRICES PLUS

SECONDARY EFFECTS OF WAGE INDEXATION, AS WELL AS LARGE WAGE INCREASES AND, ON THE SUPPLY SIDE, CONTINUED EFFECTS OF CAPACITY SHORTAGES. ON EXTERNAL SIDE, CURRENT ACCOUNT DEFICIT OF 3 BILLION KR. WAS DUE TO (1) ABOLITION OF IMPORT SURCHARGES, (2) SPECULATIVE PURCHASES OF INDUSTRIAL RAW MATERIALS AT TIME OF RISING PRICES, AND LOST EXPORTS DUE TO LABOR CONFLICTS. DANES AGREED THAT 1973 WAS YEAR OF LOST OPPORTUNITIES ON EXPORT SIDE, BUT DID NOT ACCEPT SECRETARIAT SUGGESTION THAT EXPORT COMPETITIVENESS WAS ON DECLINING TREND. (DIAGRAM 3, REFD0C).

3. POLICY PERFORMANCE IN 1973. DANISH POLICY AIMS IN 1973 WERE TO RESTRICT PUBLIC CONSUMPTION AND CONSUMER DEMAND, TO ENCOURAGE FINANCING OF DOMESTIC INVESTMENT FROM ABROAD, AND TO RESTRAIN GROWTH OF HOUSING STARTS IN ORDER REDUCE PRESSURES ON LABOR SUPPLY. EDRC TOOK VIEW THAT MEASURES WERE TOO LITTLE OR TOO LATE AND THAT DANES COULD HAVE DONE MORE THAN THEY DID TO RESTRAIN DEMAND. FIRST, ALTHOUGH DANES CUT BACK PUBLIC EXPENDITURE AND CREATED CASH SURPLUS WHICH WOULD NORMALLY HAVE DEFLATIONARY IMPACT, THEY DID NOT SUFFICIENTLY RESTRICT OPEN MARKET OPERATIONS OR CREDITS TO PRIVATE BANKS. SECOND, AS US POINTED OUT, DANISH EFFORTS TO ENCOURAGE INVESTMENT FINANCING FROM ABROAD VIA HIGH DOMESTIC INTEREST RATES LED TO EXCESSIVE CAPITAL INFLOW WHICH UNDERMINED DOMESTIC MONETARY RESTRAINT AND GAVE ADDITIONAL IMPETUS TO INFLATION. (SECRETARIAT NOTED THAT 5.5 BILLION KR. INFLOW MORE THAN OFFSET 3 BIL. KR. CURRENT ACCOUNT DEFICIT.) THIRDLY, RESTRAINTS ON HOUSING STARTS WERE NOT VERY STRICT UNTIL HALF WAY THROUGH 1973. DANES REMARKED LAMELY THAT RESTRICTIVE MEASURES NOT INTRODUCED EARLIER BECAUSE GOVERNMENT THOUGHT IT HAD ALREADY OBTAINED AGREEMENT OF PRIVATE CREDIT INSTITUTIONS TO RESTRICT GROWTH OF CREDIT.

4. OUTLOOK FOR 1974: DANES DID NOT PROVIDE SPECIFIC FIGURES FOR GNP OR CPI GROWTH, ALTHOUGH NOTING THAT WAGES WILL PROBABLY RISE 20 PERCENT IN 1974, OF WHICH LIMITED OFFICIAL USE

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12 PERCENT DUE TO INDEXATION AND 6 PERCENT TO WAGE DRIFT. DANES NOW THOROUGHLY DISENCHANTED WITH INDEXATION SYSTEM WHICH IN TIME OF RAPID INFLATION, HAS SUCCEEDED ONLY IN TRANSLATING EXTERNAL PRICE INCREASES INTO DOMESTIC WAGE-PRICE-WAGE SPIRAL. THEY HOPE TO TRADE OFF PROJECTED INCOME TAX REDUCTIONS IN 1975 AGAINST LESS RIGID INDEXATION ARRANGEMENTS AT NEXT WAGE BARGAINING ROUND. TAX REDUCTION WILL BE

ONE ELEMENT OF FIGHT AGAINST INFLATION, WHILE PRICE
AND INCOMES POLICY MAY BE INTRODUCED IN FALL.

5. EDRC QUESTIONED DANISH TAX PLANS ON SEVERAL
COUNTS. FIRST, THERE WAS DANGER THAT INCREASE OF VAT

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IN EARLY 1975 COMBINED WITH EXPECTED REDUCTION IN
INCOME TAXES WOULD LEAD TO SPENDING SPREE IN LATE
1974 AND UNDERMINE DEMAND RESTRAINT. TO THIS DENMARK
REPLIED THAT MAY 1974 SPECIAL TAXES ON AUTOMOBILES
WOULD EXPIRE AT SAME TIME AS VAT INCREASES BY 5 PER-
CENT IN JANUARY 1975, THUS REDUCING DANGER OF
SPENDING SPREE. SECOND, AS US NOTED, THERE WERE BOTH
ECONOMIC AND EQUITY REASONS FOR INCREASING DIRECT
TAXES RATHER THAN INCREASING IN-DIRECT TAXES. IN-
DIRECT TAXES WOULD SIMPLY GIVE FURTHER STIMULUS TO
TAX-PUSH INFLATION AND WOULD HIT LOWER INCOME GROUPS
HARDEST. TO THIS DANES REPLIED THERE WAS NO FURTHER
LEEWAY FOR DIRECT TAX INCREASES IN PRESENT CLIMATE

OF TAX RESISTANCE.

6. BALANCE OF PAYMENTS: DANES EXPECT MAY 1974 MEASURES TO RESULT IN 1 BILLION KR. IMPROVEMENT IN CURRENT ACCOUNT BALANCE WITH DEFICIT NOW FORESEEN AT 7 BILLION KR. IN 1974. THEY SEE SUBSTANTIAL DECLINE IN IMPORT DEMAND AS DOMESTIC RESTRAINT TAKES HOLD. IMPORT LIMITED OFFICIAL USE

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VOLUMES SEEN INCREASING ONLY 1 PERCENT IN 1974 WHILE EXPORTS RISE 10 PERCENT, WITH RESULT THAT NON-OIL DEFICIT WILL BE WIPED OUT BY END OF 1974. DANES DO NOT EXPECT PROBLEMS IN FINANCING DEFICIT THIS YEAR OR NEXT, ASSUMING STABILITY OF EXCHANGE RATE. THEY INTEND TO REMAIN IN CURRENCY SNAKE, SINCE DEPARTURE WOULD INVOLVE DEVALUATION WHICH WOULD OFFER NO BENEFITS ON EXPORT SIDE AT TIME OF CAPACITY SHORTAGE AND WOULD RAISE COST OF IMPORTS, UNDERMINING ANTI-INFLATION PROGRAM.

8. REGARDING DANISH PLANS FOR SHIFTING RESOURCES INTO EXTERNAL SECTOR, DANES ARE USING DEMAND MANAGEMENT POLICY AND RESTRICTIONS ON HOUSING STARTS TO RESOLVE RECENT LABOR MARKET IMBALANCES. THIS MAY RESULT IN SOME UNEMPLOYMENT, PERHAPS RISING TO 1 PERCENT OF LABOR FORCE, BUT SOME SHIFT IN RESOURCES FROM CONSTRUCTION TO INDUSTRY MAY BE ACHIEVED. DANES NOTED THAT IT WAS DIFFICULT TO USE SELECTIVE MEASURES FAVORING EXPORT INDUSTRIES BECAUSE MOST INDUSTRIES PRODUCED BOTH FOR DOMESTIC AND FOREIGN MARKETS. BROWN

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